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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 268

O. WILLIAM LOWRY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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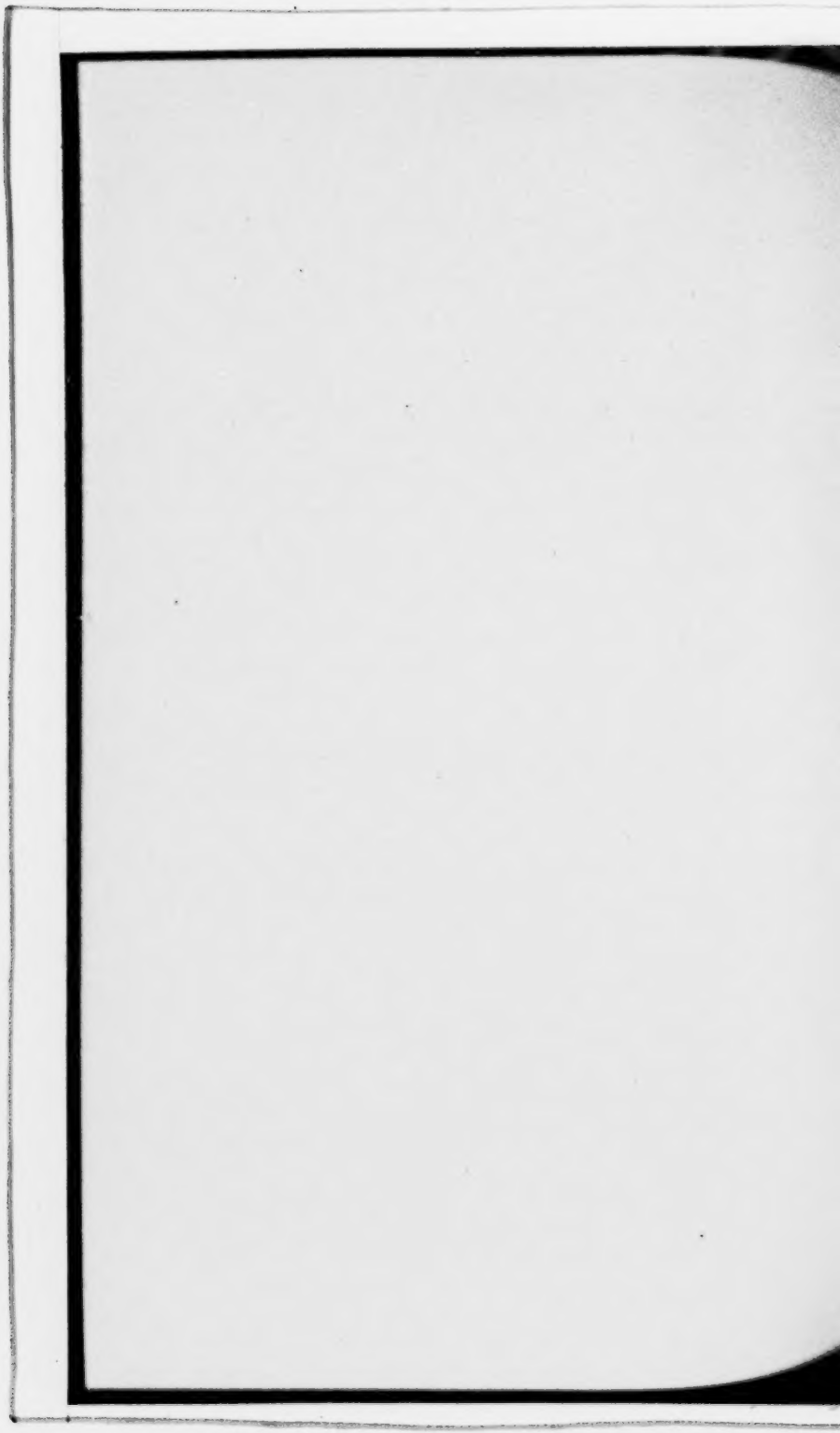

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PETITION FOR WRIT OF CERTIORARI.

To the Honorable, The Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of O. William Lowry, a citizen of the State of Michigan, respectfully shows:

Statement of Matter Involved.

The matter involved in the case of this petitioner (which case was consolidated for hearing in the court below with that of Charles R. Sligh, Jr., who is not petitioning) is the taxability of the petitioner on income of petitioner's wife which she received under a limited partnership agreement.

The Circuit Court of Appeals for the 6th Circuit held (Rec. 222; *Lowry* v. *Commissioner of Internal Revenue*, 154 F. 2d 448) that the present petitioner's case was controlled by the decision of this Court in *Commissioner of Internal Revenue* v. *Tower* (October Term, 1945, decided February 25, 1946).

There is no dispute anywhere in the record of the fact that the petitioner's wife, Sara H. Lowry, made a capital contribution to the partnership consisting of 450 shares of stock in a corporation which shares she had received as an outright gift from her husband more than eighteen months prior to the making of such contribution to the partnership assets (Rec. 43).

Furthermore, there is not a scintilla of evidence sustaining any conclusion that the antecedent gift of the corporate shares which Sara H. Lowry contributed to the capital of the partnership was merely a step in the proceeding by which the partnership was formed, more than a year later (Rec. 47). There is no finding of fact anywhere by the Tax Court that such transfer of corporate shares from husband to wife was intended to be or was a step in the plan for the formation of the partnership (Rec. 182-183).

It is true that in the opinion filed by a majority of the Tax Court it is said (Rec. 192):

> "It is clear that the petitioners made the alleged gifts of stock in the corporation to their wives pursuant to a plan involving the dissolution of the corporation and the transfer of assets to a partnership."

Six judges (Black, Arundell, Leech, Mellott, Disney and Van Fossan) dissented from this opinion (Rec. 196-201) and in the absence of either evidence or of a finding of fact by the Tax Court that the gift of corporate stock to Mrs. Lowry was made with a view to her using it as a

contribution to a partnership thereafter to be formed, it is submitted that the reasons given by the majority of the Tax Court for their opinion do not rise to the dignity of findings of fact to which this Court has given conclusive effect.

Basis Upon Which This Court Has Jurisdiction.

The jurisdiction of this Court is given by Section 240 of the Judicial Code as amended by the act of February 3, 1925, 28 U. S. Code 347, para. (a), which provides in part:

> "(a) In any case * * * in a circuit court of appeals * * * it shall be competent for the Supreme Court of the United States * * * to require by certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by it, and with like effect, as if the cause had been brought there by unrestricted appeal."

The provision of Rule 38 of this Court which is deemed pertinent to the allowance of this petition for certiorari is that the Circuit Court of Appeals has decided an important question of Federal law which has not been but should be settled by this Court and has decided a Federal question in a way probably in conflict with applicable decisions of this Court.

The question presented is whether a wife who makes a contribution to a partnership in which her husband and two other persons are to become engaged is a bona fide owner of a partnership interest where the contribution made by her was under State law her own property, even though it originated more than a year and a half earlier from a gift made to her by her husband—there being no evidence or finding of fact that the gift was made to her as part of a plan of forming such partnership.

Reasons For Allowance of Writ.

The writ should be allowed because the court below has given the same effect to mere discussions contained in the opinion of the Tax Court as the Supreme Court allows to findings of fact of the Tax Court. Although there is no finding of fact that the gift of corporate stock from the petitioner to his wife, Sara H. Lowry, in May, 1937, was any part of the plan by which a limited partnership was formed more than eighteen months thereafter, the language of the Tax Court in giving the reasons for its decision has been accepted by the Circuit Court of Appeals as though that language constituted findings of fact.

Furthermore, the Circuit Court of Appeals has failed to recognize that under the decisions of this Court, income taxes cannot be levied against the husband if, in fact, his wife is a partner—and that in determining the fact of a partnership the question of the wife's contribution to the capital of the partnership must be considered.

The Circuit Court of Appeals did not recognize the absence of evidence that the gift to Mrs. Lowry was any part of the plan for formation of a partnership and was misled by the reasons (as distinguished from findings of fact) of the Tax Court.

Another reason for the allowance of a writ is that this Court—should it adhere to the fullest implication of its family partnership decisions—will create a distressing condition. The property rights of husbands and wives as between themselves are governed by State law and if this Court has meant to take the position that the actualities of the State law may be entirely disregarded in determining Federal income tax questions, the result will be that in numerous instances husbands will be obligated to pay over to their wives without deduction for Federal taxes amounts

which such taxes have completely wiped out. Unless this Court is prepared to obliterate substantive rules of State law by imposing income tax rules which make it impossible to recognize the actualities of the property rules of the States, it should reconsider some of the language of its decisions on family partnerships.

Prayer of the Petition.

Wherefore, your petitioner, O. William Lowry, respectfully prays that a writ of certiorari be granted in this case to review the judgment and decision of the United States Circuit Court of Appeals for the 6th Circuit entered April 3, 1946, in the cause there entitled "General Number 9920, O. William Lowry, Petitioner, *vs.* Commissioner of Internal Revenue, Respondent", which in the United States Tax Court bore Docket No. 112691.

O. William Lowry,
Petitioner,
By Owen Rall,
Tim G. Lowry,
His Attorneys.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. .....

O. WILLIAM LOWRY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

(a) Index.

The index to this brief will be found ahead of the petition for certiorari to which this brief is bound.

(b) Opinions below.

The opinion of the Tax Court is reported, 3 T. C. 730, and of the Circuit Court of Appeals, 6th Circuit, 154 F. 2d 448.

(c) Jurisdiction.

In the petition for certiorari, under the jurisdictional point, will be found the statutory and rule 38 provisions which authorize a writ of certiorari.

(d) Statement of the case.

Effective January, 1937, the Charles R. Sligh Company, furniture manufacturers of Holland, Michigan, with 1800 shares of corporate stock outstanding, was owned 900 shares by petitioner, O. William Lowry, and 900 shares by Charles R. Sligh (Rec. 37, 39). Sara Lowry, petitioner's wife, and Charlotte K. Sligh, Charles R. Sligh's wife, were elected directors at that time and together with their husbands served as directors as long as the corporation continued in existence (Rec. 37). A portion of petitioner's then stock holdings was purchased in January, 1937, from Mr. Matheson with money, $15,000.00, borrowed from a bank on the joint note of petitioner and his wife (Rec. 83, 109).

Petitioner desired to make a gift of a portion of his stock to his wife so that she might have independence of petitioner's creditors (Rec. 41). On May 24, 1937, petitioner gave his wife 450 shares of the 900 shares of stock owned by him, accompanying it with a letter which is not and cannot be challenged, stating in part (Rec. 43):

> "This is a gift from me to you, and is now your property to do as you choose. There are no restrictions upon your rights as a stockholder and you are entitled to receive any dividends which may be paid on the stock from this day forth."

In order to make this unconditional gift, petitioner obtained the release of the shares from the bank where they were pledged as collateral to the joint note of petitioner and his wife (Rec. 85, 110).

At the time in January, 1937, of acquiring control in equal shares (through purchase of Matheson's interest which had been one-third), Mr. Sligh and the petitioner discussed a change in the business structure from that of

a corporation because it was unwieldy, reports to be made out, etc., and because of tax savings (Rec. 44). No partnership was formed because that would have involved liabilities that they were not sure they wished to assume (Rec. 45).

A year after Mrs. Lowry received her stock, that is, in the spring of 1938, there were discussions about the formation of a limited partnership, and eighteen months after Mrs. Lowry received her stock a limited partnership was formed the validity of which is not challenged under the laws of the state of Michigan. Mrs. Lowry surrendered her stock interest in the corporation for a corresponding interest, as a limited partner, in the partnership (Rec. 47). In the meantime, Mrs. Lowry received a dividend of $7,500.00 paid in corporate notes in May 1937 (Rec. 54-55, 124) and of $1,800.00 paid in cash on May 25, 1938 (Rec. 55, 124).

There was no finding of fact by the Tax Court that the petitioner's gift of stock was not actual, unconditional and complete. It found as a fact (Rec. 190):

> "Petitioners did not relinquish dominion and control over any part *of the assets of the corporation* by reason of the gift of stock in the corporation to their wives, and, *consequently,* the wives did not contribute any property to the capital of the partnership."

The shares of stock involved in petitioner's gift never were "assets of the corporation." No one ever pretended that they were. There is no finding of fact anywhere in the record that the gift of shares was not unconditional, actual and complete. As an officer of the corporation, of course petitioner's control over its assets was the same after as before his gift of corporate stock to his wife. But that is wholly beside the point. The question here was not whether the assets of the corporation were under

the control of petitioner and Charles R. Sligh, but whether the shares of corporate stock given by petitioner to his wife continued to be under petitioner's control. There is no evidence and there is no finding that they were.

The entire basis of the Tax Court's decision was that the petitioner's wife made no contribution to the capital of the partnership. In turn, this is based solely on the untenable theory that the lack of a change in control of the assets *of the corporation*—not of its corporate stock—proves that the gift of corporate stock is invalid, so that its use more than eighteen months later cannot constitute a contribution to the capital of the partnership.

(e) Errors assigned.

The Tax Court and the Court below erred:

1. By assuming that a gift of corporate stock was legally the same as a gift of an equivalent portion of corporate assets and by attempting to test the validity of the gift of corporate stock by looking at the control over corporate assets instead of the control over the corporate stock which was the subject of the gift. A person owning shares in American Telephone and Telegraph Company, as an example, has no control whatever over the assets of the company, but he is no less the owner of valuable shares.

2. In testing the validity of the gift of corporate stock made eighteen months before by referring to the provisions of the partnership agreement made in December, 1938.

3. In deciding that the petitioner was not carrying on business in a partnership form under section 181 of the Internal Revenue Code.

4. In sustaining the deficiency against petitioner for the years 1939 and 1940.

(f) Argument.

The two concluding paragraphs of the Tax Court's findings of fact are as follows (Rec. 190):

> "Respondent has included in the income of each petitioner for each year, 1939 and 1940, the amounts reported by the wife in her separate return as her share of partnership income. The reason given for such determination, as stated in the deficiency notice, is that the wife's share of partnership income is held taxable to the husband because the wife rendered no services and contributed no capital, as such, to the business, and because the husband in the close family group retained 'dominion, control, and administration' of the business.
>
> "Petitioners did not relinquish dominion and control over any part of the assets of the corporation by reason of the gifts of stock in the corporation to their wives, and, consequently, the wives did not contribute any property to the capital of the partnership."

This is an evasive and immaterial finding. The conclusion that "the wives did not contribute any property to the capital of the partnership" is a perfect *non sequitur*, based upon an immaterial finding of fact and therefore the conclusion falls of its own weight. The decision based upon it also must fall.

The dissenting opinion of Judge Black (Rec. 196) called attention to the error in the finding of fact, but not to its immateriality.

Judge Black, with whom Judges Arundell, Leech, Mellott and Disney concurred, expressed the dissent from these conclusions (Rec. 196-197):

> "I do not agree to the correctness of the above ultimate findings of fact. I think it is contrary to the findings of fact which have preceded it. Based on the

general findings of fact which the majority has made, I would find ultimate facts as follows:

> "Petitioners Lowry and Sligh made irrevocable gifts to their wives of 450 shares each of Charles R. Sligh corporation stock. When this corporation was liquidated and dissolved in December, 1938, the wives became the owners of their proportional part of the assets of the corporation. The partnership agreement entered into December 16, 1938, between petitioners and their wives created a legal, valid partnership between them with ownership of partnership profits as fixed in the partnership agreement. The earnings of the partnership thereafter allocable to the respective partners under the terms of the partnership agreements were the income of the respective partners to whom allocable."

Judge Disney wrote a separate dissenting opinion to express his view that the conclusion of the majority was an erroneous conclusion of law since "the majority view fails to give weight to certain basic law on the subject of gifts" (Rec. 198). In this opinion Judges Arundell, VanFossan, Black and Leech concurred.

Thus six of the sixteen judges of the Tax Court held that there was no sufficient legal basis in the facts as found for the conclusion of the majority.

Two propositions were clearly held by the Tax Court (Rec. 192):

> "We have said that it is essential that a contribution be made by each member of a partnership of either property or services in order that a partnership may be found to exist. *Thomas M. McIntyre*, 37 B. T. A. 812. See also, *Meehan* v. *Valentine*, 145 U. S. 611. In this case the wives of petitioners did not contribute any services to the business. The question to be considered is whether they contributed any capital or property to the business.
>
> • • • • •

> "If the wives received such dominion over property, it will follow that they, individually, made real contributions to the capital of the partnership."

This statement recognizes:

(1) That if a wife contributed capital the partnership existed; and

(2) That if the gifts of corporate stock were valid Mrs. Lowry contributed capital to the partnership.

There was ~~no~~ an error of law in holding that the gifts of stock were ineffective. Were it not for the result reached in the court below, it could not seriously be argued that the gift to Mrs. Lowry was not to be recognized. The subject matter of the gift was shares of corporate stock. There was ~~no~~ positive proof of delivery, of donative intent, and of acceptance. The shares were transferred on the stock book of the corporation and a certificate was issued in the name of the donee. She did not endorse her certificate for transfer. She did not give her husband a power of attorney to transfer her shares.

All elements of a valid and effective gift were present. In *Molenda* v. *Simonson*, 307 Mich. 139, pp. 141-142, it was said:

> "Three elements are necessary to constitute a valid gift. The donor must possess the intent to gratuitously pass title to the donee. *Chamberlain* v. *Eddy*, 154 Mich. 593, 603, and *Geisel* v. *Burg*, 283 Mich. 73, 80. An actual or constructive delivery is essential to effectuate a gift either *inter vivos* or *causa mortis*. *In re Van Wormer's Estate*, 255 Mich. 399. In order for the gift to be consummated, the donee must accept it, although a gift beneficial to the donee will be presumed to have been accepted. *Holmes* v. *McDonald*, 119 Mich. 563 (75 Am. St. Rep. 430)."

There is no evidence and no finding of fact anywhere in the record that the undisputed, unconditional and outright

gift of stock from petitioner to his wife in May, 1937, had anything to do with the later formation of the partnership. We challenge the respondent to point out any substantial evidence that the two things were related in any way except by the intervention of eighteen months.

The majority of the Tax Court said (Rec. 192):

> "Petitioners were the owners of all of the stock and, therefore, of all of the assets of the corporation in the beginning. If they made bona fide gifts of interests in part of the assets to their wives, through the medium of transfers of stock, their wives must have received complete dominion and control over property, and petitioners must have divested themselves of such control. Such rule is well established. See *Edson* v. *Lucas*, 40 Fed. (2d) 398, and authorities cited therein on the essential elements of a bona fide gift. If the wives received such dominion over property, it will follow that they, individually, made real contributions to the capital of the partnership."

The fallacy in this is obvious. The petitioner as owner of corporate stock was not the owner "of all of the assets of the corporation in the beginning".

1 Fletcher Cyc. of Corp. (Per. Ed.) p. 2, states:

> "Introductively it may be assumed that now a corporation is one of the forms of association, having rights and relations, and the characteristic attribute of a legal entity distinct from that of the persons who compose it or act for it in exercising its functions."

No right to deal directly with the corporate assets was an incident of ownership of the stock. The petitioner had no such power before the transfer and could confer no such power on his wife. The degree of control over the affairs of the corporation which Mrs. Lowry acquired or possessed as owner of a minority interest in its stock is a question to be answered by the law of corporations, not by the law of gifts.

In *Edson* v. *Lucas,* 40 Fed. (2d) 398, it is pointed out that the delivery necessary to effect a valid gift must be such that the donor parts with dominion and control, as well as possession, *over the subject-matter of the gift.* We quote from p. 405:

> "It is safe to say that, where there is a complete transfer of the legal title to the subject-matter of the gift, together with some equitable or beneficial present interest, to the donee, without power of revocation in the donor, coupled with the intentional delivery of complete possession, dominion and control over the gift, the gift is not invalid because of conditions imposed by the donor which are not inconsistent with the immediate vesting of such legal title in the donee."

When attention is directed to the matter, it is rather obvious that, in the statement last quoted from the opinion, the majority of the Tax Court were confusing the wives' degree of control over corporate assets with their degree of control over shares of stock. Having made this fundamental error it was much easier to make the next error, which consisted of using the partnership agreement to test the character and extent of the ownership conferred by the transfer of the stock. Since the property which was the subject matter of each gift was stock, not an undivided interest in corporate assets or even a share in the partnership, the reasoning was plainly wrong. There is no proof whatsoever, and no finding by the Tax Court, that there was any restriction or limitation upon ownership *of the stock as property* by the wives. There is no finding that there was any restriction upon exercise by each wife of every right usually exercisable by a stockholder, unless the finding that the stock had to be first offered to the remaining stockholders before it could be sold to an outsider, (Rec. 183), is such a restriction. There is not even a suggestion that either Lowry or Sligh could, in any contingency, get back his stock from his wife.

It is, therefore, abundantly clear that, once this error in the reasoning of the Tax Court is corrected, settled principles of law demand that the gifts of stock be held valid. Such holding is decisive of the case and requires reversal.

There is not even reasonably close relationship in point of time to justify the conclusion that the gift made by Petitioner Lowry was conditional. The holding that that gift was not *bona fide* is the *reductio ad absurdum* of the failure of the majority of the Tax Court to apply settled legal principles to determine whether the gift was valid, and of the confusion of control over stock with control over assets of the corporation whose stock was involved.

The transfer to Mrs. Lowry was made on May 25, 1937, (Rec. 43). Lowry wanted his wife to have some property of her own, (Rec. 84, 111). Before he made the gift the formation of a partnership had been discussed and *Sligh and Lowry had decided against doing so* because they were not ready to assume the personal liability which a partnership would involve, (Rec. 45). The proofs affirmatively show that Lowry could not have had in mind the formation of a partnership when he gave half his stock to his wife. Mrs. Lowry received two dividends upon the stock amounting to $9,300, (Rec. 54-55, 86-87, Exhs. 12 and 13). It is not suggested that her husband had any claim to this money.

Since there is no rational basis in the undisputed facts for even an inference that the gift of stock was made upon condition that a partnership be formed, the petitioner's wife contributed capital to the partnership and the partnership should be recognized.

The dissenting opinions in the Tax Court were plainly correct and the decision of the Circuit Court of Appeals in affirming the majority decision should, we submit, be

reversed. The petitioner will perhaps ask leave later to submit a supplemental brief on the law as disclosed by recent so-called family partnership cases, but it is apparent that the basis of the Tax Court's decision was wrong and that the decision should fall with the disclosure of that error.

Respectfully submitted,

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July 1, 1946.